

ARIZONA-AMERICAN WATER COMPANY

DOCKET NO. W-01303A-05-0405

and

DOCKET NO. W-01303A-05-0910

SURREBUTTAL TESTIMONY

OF

RODNEY L. MOORE

ON BEHALF OF

THE

RESIDENTIAL UTILITY CONSUMER OFFICE

MARCH 6, 2006

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1 **INTRODUCTION**

2 Q. Please state your name for the record.

3 A. My name is Rodney Lane Moore.

4

5 Q. Have you previously filed testimony regarding this docket?

6 A. Yes, I have. I filed direct testimony in this docket on January 26, 2006.

7

8 Q. What is the purpose of your surrebuttal testimony?

9 A. My surrebuttal testimony will address the Company's rebuttal comments
10 pertaining to adjustments I sponsored in my direct testimony.

11

12 **SUMMARY OF ADJUSTMENTS**

13 Q. What areas will you address in your surrebuttal testimony?

14 A. My surrebuttal testimony will address the following RUCO proposed
15 adjustments:

16 1. Operating Income Adjustment No. 1 – Reclassification of Office
17 Lease;

18 2. Operating Income Adjustment No. 4 – Rate Case Expense;

19 3. Operating Income Adjustment No. 5 – Pension Expense;

20 4. Operating Income Adjustment No. 7 – Normalize Labor;

21 5. Operating Income Adjustment No. 8 – Depreciation Expense;

22 6. Operating Income Adjustment No. 9 – Property Taxes;

23 7. Operating Income Adjustment No. 11 – Normalize Payroll Taxes;

- 1 8. Operating Income Adjustment No. 12 – Administration and General
2 Allocated Costs;
3 9. Operating Income Adjustment No. 16 – Income Tax Expense; and
4 10. Arsenic Cost Recovery Mechanism.

5
6 To support the adjustments to my surrebuttal testimony I prepared eight
7 Surrebuttal Schedules numbered SURR RLM-1, SURR RLM-2, SURR
8 RLM-3, SURR RLM-6, SURR RLM-7, SURR RLM-11, SURR RLM-12 and
9 SURR RLM-13, which are filed concurrently in my surrebuttal testimony.

10

11 **OPERATING INCOME**

12 **Operating Income Adjustment No. 1 – Reclassification of Office Lease**

13 Q. Have you reviewed the Company's rebuttal testimony concerning your
14 adjustment to reclassify the office lease expense?

15 A. Yes. RUCO accepts the Company's calculation of this expense.

16

17 Therefore, I made the following correction in my surrebuttal testimony:

18 RUCO's Adjusted Expense	(\$1,185)
19 RUCO's Direct Testimony Adjusted Expense	<u>(\$14,593)</u>
20 RUCO's Surrebuttal Adjustment	\$13,408

21

22 As shown on Schedule SURR RLM-3, page 1, column (A), line 22, this
23 adjustment increases adjusted test-year expenses by:

24 \$13,408.

Operating Income Adjustment No. 4 – Rate Case Expense

Q. After analyzing the Company's rebuttal testimony, is RUCO revising its adjustment to rate case expenses?

A. Yes, in light of the Company witness Mr. Townsley's rebuttal testimony announcing the Company's intention to file the next PV Water rate case not later than September 30, 2008; RUCO has recalculated the appropriate annual level of rate case expenses associated with this proceeding. RUCO accepts the Company's proposed amortization period of three years.

However, RUCO does not agree with the Company's Rebuttal recommendation to burden the ratepayers with \$301,832 in rate case expenses, an increase of \$18,985 over its initial filing in this proceeding. RUCO maintains its direct testimony analysis was thorough and an accurate basis for determining a reasonable financial burden on ratepayers for rate case expenses.

Moreover, to further illuminate the reasonableness of RUCO's position I refer to the Commissioners' position on such expenses in AZ-AM's most recent rate case affecting ten of AZ-AM's districts as stated in Decision No. 67093, dated June 30, 2004 on page 20, lines 17 to 19:

"Based on our review of the complexity of this proceeding, the number of systems involved in this rate request, and a

1 comparison of other cases, we find that rate case expense in
2 the amount of \$418,941 is reasonable for this proceeding.”
3

4 I incorporated the same criteria as the Commission did when it approved
5 rate case expenses of \$418,941 (or \$41,894 per district) as part of the
6 analysis in my direct testimony on page 10 starting at line 10.
7

8 RUCO disagrees with respect to the Company’s assertion that the instant
9 case is “complex” because it addresses \$35 million in new investment in
10 arsenic removal and fire flow improvement infrastructure – a tripling of the
11 prior rate base. The costs associated with arsenic removal are not an
12 issue in this case and will be properly addressed in the Company’s filing
13 for ACRM Step One capital costs later this year.
14

15 The costs incurred by the Company to argue its request to recover capital
16 investments associated with fire flow improvements in the instant case are
17 not a justifiable ratepayer expense. Ratepayers should not be charged for
18 the Company’s choice to incur the expense necessary to present
19 unorthodox arguments about discretionary items, and that the amount of
20 allowable rate case expense should therefore be reduced. This position is
21 concurrent with statements approved by the Commissioners in Decision
22 No. 67093, dated June 30, 2004 on page 19, lines 3 to 5.
23

...

1 Therefore, I calculated my surrebuttal adjustment to rate case expenses
2 as:

3 RUCO's Adjusted Expense ($\$73,179 / 3 = \$24,393$)	\$24,393
4 RUCO's Direct Testimony Adjusted Expense	<u>\$14,636</u>
5 RUCO's Surrebuttal Adjustment	\$9,757

6

7 As shown on Schedule SURR RLM-3, page 1, column (D), line 22, this
8 adjustment increases adjusted test-year expenses by:
9 \$9,757.

10

11 **Operating Income Adjustment No. 5 – Pension Expense**

12 Q. After analyzing the Company's rebuttal testimony, is RUCO revising its
13 adjustment to the pension expense?

14 A. Yes. After reviewing the Company's rebuttal adjustment to normalize
15 labor, RUCO revised its test-year labor costs to include additional labor
16 costs.

17 Therefore, in association with an increase in labor costs, pension
18 expenses increased because of the additional number of full time
19 equivalent PV Water employees.

20

21 Please see the following Operating Income Adjustment No. 6 – Normalize
22 Labor for a full explanation.

23 ...

1 As shown on Schedule SURR RLM-6, I calculated my surrebuttal
2 adjustment to pension expenses as:

3	RUCO's Adjusted Expense	\$22,409
4	RUCO's Direct Testimony Adjusted Expense	<u>\$21,735</u>
5	RUCO's Surrebuttal Adjustment	\$674

6
7 As shown on Schedule SURR RLM-3, page 1, column (E), line 22, this
8 adjustment increases adjusted test-year expenses by:
9 \$674.

10
11 **Operating Income Adjustment No. 7 – Normalize Labor**

12 Q. After analyzing the Company's rebuttal testimony, is RUCO revising its
13 adjustment to normalize labor?

14 A. Yes. This Company adjustment is based on the recommendation for
15 inclusion of two labor elements. The first element is to replace two full-
16 time employees for seven part-time employees, for an increase of 665.5
17 test-year labor hours. The second element is to include an arsenic plant
18 operator hired on October 10, 2005, for an increase of 2,080 test-year
19 labor hours. RUCO analyzed the Company's rebuttal testimony and
20 accepts the first element, but rejects the second element.

21 . . .

22 . . .

23 . . .

1 Q. Please discuss RUCO's position on the Company's first element of this
2 rebuttal adjustment.

3 A. As fully explained in my direct testimony on page 15 starting at line 16, I
4 accurately calculated the level of test-year labor which provided the utility
5 service to the test-year customer base. This balances the cost of
6 providing service with the revenue generated. However, the Company
7 provided additional information that fully explained why the pro forma
8 adjustment attempts to reflect optimum working conditions outside the test
9 year. RUCO accepts this adjustment as a more accurate depiction of test-
10 year labor required to sustain adequate utility service.

11
12 Therefore, I will increase test-year labor by 665.5 hours or \$7,825 as
13 shown on Schedule SURR RLM-7. Subsequently, Income Adjustment No.
14 5 – Pension Expense and Income Adjustment No. 11 – Normalized Payroll
15 Taxes are adjusted to reflect the ramifications of this increase in test-year
16 labor.

17
18 Q. Please explain RUCO's rejection of the Company's second element of this
19 rebuttal adjustment.

20 A. The Company is proposing to embed labor hours associated with the
21 arsenic removal project into PV Water's test-year operation and
22 maintenance expenses. This is in direct contradiction to the Company's
23 request for ACRM cost recovery as stated in Mr. Stephenson's direct

1 testimony on page 15, starting at line 18, which states in part: "The ACRM
2 rate recovery is based solely on actual and eligible costs and commences
3 after new arsenic facilities are in service."

4
5 Since costs associated with the arsenic facilities are not part of the instant
6 case and the arsenic facilities are not in service yet, the arsenic plant
7 operator hours cannot be allowed in test-year O & M expenses.

8
9 Moreover, even if the inclusion of the arsenic plant operator were to be
10 considered, his impact on PV Water operating expenses would be through
11 a Central Division Allocation of 8.12% for these costs. Company witness
12 Mr. Biesemeyer states, in part, in his rebuttal testimony on page 2, starting
13 at line 6 that this new arsenic plant operator will take part in the
14 operational testing for all of the new arsenic plants in the Central Division.

15

16 Q. Please summarize your total adjustment to normalize labor.

17 A. I accepted the Company's recommendation to increase test-year labor to
18 include a full time meter reader and a customer service representative; but
19 I rejected the Company's proposal to include an arsenic plant operator.

20

21 As shown on Schedule SURR RLM-7, I calculated my surrebuttal
22 adjustment to normalize labor in two steps (First, labor for Operations
23 activities; and Second, labor for Maintenance activities):

1	1.	Normalized Operations Labor:	
2		RUCO's Adjusted Expense	\$316,021
3		RUCO's Direct Testimony Adjusted Expense	<u>\$310,300</u>
4		RUCO's Surrebuttal Adjustment	\$5,721

5			
6	2.	Normalized Maintenance Labor:	
7		RUCO's Adjusted Expense	\$116,056
8		RUCO's Direct Testimony Adjusted Expense	<u>\$113,955</u>
9		RUCO's Surrebuttal Adjustment	\$2,101

10

11 As shown on Schedule SURR RLM-3, page 2, column (G), line 37, this

12 total adjustment increases adjusted test-year expenses by:

13 \$7,822 (\$5,721 + \$2,101 = \$7,822).

14

15 **Operating Income Adjustment No. 8 –Depreciation Expense**

16 Q. After analyzing the Company's rebuttal testimony, is RUCO revising its

17 adjustments to the depreciation expenses?

18 A. No. RUCO does not accept the Company rationale for denying the

19 ratepayers their full entitlement of the compensation on the gain from the

20 sale of land.

21 . . .

22 . . .

23 . . .

24 . . .

25 . . .

1 Q. Please outline the issues the Company raised over the distribution of the
2 gain from the sale of land that you reject as part of your responsibilities in
3 this rate proceeding.

4 A. Company witness Mr. Reiker discusses issues in his rebuttal testimony
5 starting on page 13 concerning the gain from the sale of land, which relate
6 to my responsibilities in this case. These issues are:

- 7 1. The Company's illusion that it has an option of whether or not to
8 make an equitable distribution of this gain to the ratepayers;
- 9 2. The Company's position that it has been more than fair to share the
10 after-tax gain with the ratepayers; based on the premise the
11 Company has already paid the income taxes on the gain; and
- 12 3. The Company's misconception that RUCO's adjustment extracts
13 from shareholders unwarranted additional amounts related to taxes
14 and interest.
15

16 Q. In response to your first concern, please explain the Company's regulatory
17 responsibility with respect to proper treatment of any gain from the sale of
18 land.

19 A. The Commission has dealt with this issue several times in the past and
20 has historically authorized a 50/50 sharing between ratepayers and
21 shareholders of any windfall profits realized by a public service utility¹.

22 . . .

¹ Decision No. 55228, dated October 9, 1986
Decision No. 57075, dated August 31, 1990
Decision No. 55175, dated August 21, 1986
Decision No. 55931, dated April 1, 1988
Decision No. 56659, dated October 24, 1989

1 Q. In response to your second concern, please explain the Company's false
2 notion that, since the Company paid all income tax upfront the ratepayers
3 should be burdened immediately with the tax liability associated with their
4 share of the gain from the sale of land.

5 A. The concept that the ratepayers should pre-pay income taxes is irrelevant
6 to whether or not the Company was assessed income taxes on the profit
7 realized from the sale of land.

8
9 The Company received a profit of \$784,496.48 from the sale of land and
10 subsequently paid \$302,185.64 in income taxes out of that profit.

11
12 However, until the Commission makes a final decision in this rate case,
13 the ratepayers will realize no benefit from the sale of this land. To assess
14 the full tax penalty on the ratepayers long before the full benefit is received
15 is contrary to recognized ratemaking principles.

16
17 If the Commission decision approves a five-year amortization period for
18 any ratepayer compensation, the Company will have had use of the
19 interest-free capital dedicated to the ratepayers' share of the gain.

20 . . .

21 . . .

22 . . .

23 . . .

Q. In response to your third concern, please explain the Company's implied accusation that RUCO's adjustment extracts from shareholders additional amounts related to taxes and interest from the sale of land.

A. The following schedule definitively shows the Company's proposal burdens the ratepayers with a "double counting" tax liability.

ACTUAL RATEPAYER'S TAX BURDEN - 50/50 SHARING OF TAXES PAID:

1. Pre-Tax Gain From Sale Of Land	\$784,496.48
2. Ratepayers' 50/50 Share Of Pre-Tax Gain	\$392,248.24
3. Income Tax Rate	38.60%
4. Ratepayers' Income Tax Burden	<u>\$151,407.80</u>

CALCULATION OF RATEPAYER'S TAX BURDEN - 5-YEAR AMORTIZATION:

COMPANY'S METHODOLOGY

1. Pre-Tax Gain	\$784,496.48	
2. Tax Rate	38.60%	
3. Taxes On Gain	<u>\$302,185.64</u>	
4. 50/50 Share Of Taxes		\$151,407.80
5. After-Tax Gain	\$481,680.84	
6. 50/50 Share Of Gain	\$240,840.43	
7. 5-Year Amortized Amount	\$48,168.09	
8. Taxes On Amortized Amount	\$18,592.88	
9. Taxes After Five Years Of Amortization		<u>\$92,964.40</u>
10. Company's Total Ratepayers' Tax Burden		<u>\$244,372.20</u>

...

...

RUCO'S METHODOLOGY

1.	Pre-Tax Gain	\$784,496.48
2.	50/50 Share Of Gain	\$392,248.24
3.	5-Year Amortized Amount	\$78,449.65
4.	Taxes On Amortized Amount	\$30,281.56
5.	Taxes After Five Years Of Amortization	<u>\$151,407.80</u>
6.	RUCO's Total Ratepayers' Tax Burden	<u>\$151,407.80</u>

This schedule clearly shows that RUCO's adjustment properly accounts for the tax burden on the annual disbursement and does not extract additional amounts related to taxes. In contrast, the Company's methodology does overstate the ratepayers' tax burden on this gain.

Moreover, the Company's attempt to portray this disbursement as a discretionary gift that should be accepted in any amount certainly distorts established ratemaking principles and denies the ratepayers any compensation for the cost-free capital or the time value of their portion of the gain to which they are entitled.

RUCO recommends its adjustment to the depreciation expense be accepted as stated in direct testimony and outlined in Schedule RLM-8.

...

...

...

Operating Income Adjustment No. 9 – Property Taxes

Q. After analyzing the Company's rebuttal testimony, is RUCO revising its adjustments to the property tax expenses?

A. No, but I understand Company witness Mr. Reiker's assessment of the difference in PV Water's tax liability; thus I will clarify RUCO's adjustment to remove any confusion about a perceived "double-dip".

Q. Please give an overview of your understanding of the difference between the Company and RUCO's adjustment to PV Water's test-year property tax expense.

A. Mr. Reiker states in his rebuttal testimony on page 39, line 7 that Motorola's test-year property taxes is calculated at approximately \$14,000 and is reflected in PV Water's adjusted property tax expense of \$213,241. I determined through the Company's response to RUCO's data request 7.04 that Motorola's actual tax liability was approximately \$56,000.

Therefore, I made an adjustment in my direct filing to correct this error. As shown on Schedule SURR RLM-2, page 2, column (B), line 33, my total direct adjustment for property tax was approximately \$42,000 (\$56,000 - \$14,000 = \$42,000).

RUCO acknowledges the Company's determination of the property taxes attributed to the Miller Road Treatment Facility ("MRTF"), but then makes

1 a further adjustment to increase MRTF's contribution to recover the actual
2 assessed tax liability.

3
4 Therefore, since I recognized the Company's adjusted test-year revenue
5 excluded any property taxes that may be attributable to the MRTF,
6 RUCO's adjustment is not a double-dip.

7

8 Q. Please clarify this difference in the level of Motorola's property tax liability;
9 where the Company's determination is about \$14,000, while RUCO's
10 assessment is \$56,844.

11 A. The Company's witness Mr. Reiker states, in part, in his rebuttal testimony
12 on page 39 starting on line 13 that Motorola disputes property taxes as an
13 operating expense and that the Company has never been reimbursed for
14 property taxes related to the MRTF.

15

16 However, the Company's property tax calculation methodology is based
17 on its adjusted test-year operating revenues; this property tax is already
18 implicitly reduced by monies received from Motorola.

19

20 Therefore, the Company's calculation using the Commission's current
21 methodology estimates MRTF property taxes at approximately \$14,000.
22 RUCO asserts that assessed property taxes of \$56,844 constitute a
23 normal or recurring expense pursuant to Section VIII (A) of the NIBW

1 contract and the Company should seek redress through the dispute
2 resolution mechanism outlined in Section XVI of the NIBW contract.
3 Ratepayers should not be burdened with property tax expenses related to
4 the MRTF.

5
6 Q. Please summarize RUCO's surrebuttal testimony to property tax
7 expenses.

8 A. I calculated the direct adjustment to property tax expenses as:

9	RUCO's Direct Adjusted Expense	\$170,117
10	Company's Direct Testimony Adjusted Expense	<u>\$213,241</u>
11	RUCO's Direct Adjustment	(\$42,907)

12

13 As shown on SURR RLM-2, page 4, column (B), line 33 this direct
14 adjustment decreased adjusted test-year expenses by:

15 (\$42,907).

16

17 **Operating Income Adjustment No. 11 – Normalize Payroll Taxes**

18 Q. After analyzing the Company's rebuttal testimony, is RUCO revising its
19 adjustment to Normalize Payroll Taxes?

20 A. Yes. After reviewing the Company's rebuttal adjustment to normalize
21 labor, RUCO revised its test-year labor costs.

22 . . .

23 . . .

1 Therefore, in association with an increase in labor costs, payroll tax
2 expenses also increased.

3

4 Please see the above Operating Income Adjustment No. 6 – Normalize
5 Labor for a full explanation.

6

7 As shown on Schedule SURR RLM-11, I calculated my surrebuttal
8 adjustment to the payroll tax expenses as:

9 RUCO's Adjusted Expense	\$37,965
10 RUCO's Direct Testimony Adjusted Expense	<u>\$37,367</u>
11 RUCO's Surrebuttal Adjustment	\$598

12

13 As shown on Schedule SURR RLM-3, page 4, column (K), line 34, this
14 adjustment increases adjusted test-year expenses by:

15 \$598.

16

17 **Operating Income Adjustment No. 12 – Administrative and General**
18 **Allocated Costs**

19 Q. After analyzing the Company's rebuttal testimony, is RUCO revising its
20 adjustments to the administrative and general allocated costs?

21 A. Yes. The Company's rebuttal adjustment consists of three elements. The
22 first element is the Company's adjustment of RUCO's reduction in Arizona
23 Corporate allocated management fees. The second element is the

1 Company's adjustment of RUCO's reduction of Central Division Corporate
2 district allocated miscellaneous expenses. The third element is the
3 Company's adjustment of RUCO's reduction of Arizona Corporate
4 allocated miscellaneous expenses.

5
6 Q. Please discuss the first element of the Company's rebuttal adjustment to
7 Arizona Corporate allocated management fees.

8 A. The Company provides additional information and differentiates among
9 the separate entries in this account; therefore, I will clarify and adjust my
10 recommended expense level for this account based on the Company's
11 rebuttal testimony.

12
13 Q. Please outline the three separate entries in this account.

14 A. The total of the Arizona Corporate allocated management fees is \$62,478
15 and is separated into the following entries:

- 16 1. American Water Incentive Plan ("AIP") for \$18,517;
17 2. Performance Pay, Stay Bonus for \$1,520; and
18 3. Other Reorganization/Downsizing and non-incentive pay expenses
19 for \$42,441.

20
21 Q. Please clarify and explain your surrebuttal adjustment to the AIP.

22 A. Company witness Mr. Townsley states in his testimony on page 16,
23 starting on line 1 that the component weighting of the AIP that is directly
24 related to financial measurements is approximately 30 percent.

1 Mr. Townsley explains the sound financial component benefits are a
2 reduced cost of debt, which reduces cost of capital and allows the
3 Company a better opportunity to raise capital.

4
5 Stockholders are the beneficiaries of the achievement of these financial
6 components. This is particularly true between rate cases. Any additional
7 profit the Company is able to achieve between rate cases accrues solely
8 to the Company's stockholders. Accordingly, since stockholders stand to
9 gain from the achievement of the financial component, stockholders
10 should bear all of the cost of its portion of the AIP.

11
12 Therefore, I continue to advocate for the disallowance of the financial
13 component or 30 percent of the AIP in the amount of \$5,555 ($\$18,517 \times$
14 $30\% = \$5,555$).

15
16 Q. Please continue with the clarification and explanation of your surrebuttal
17 adjustment to the AIP and the Performance Pay and Stay Bonus.

18 A. The remaining AIP of \$12,962 ($\$18,517 - \$5,555 = \$12,962$) and the
19 second separate entry of the Arizona Corporate allocated management
20 fees of performance pay and stay bonus of \$1,520 does provide benefits
21 to both shareholders and ratepayers. The remaining total of AIP is
22 \$14,482 ($\$12,962 + \$1,520 = \$14,482$).

23 . . .

1 Mr. Townsley discusses the remaining two components of the AIP as
2 recognition for operational and individual goals. Indicators for these
3 components measure customer satisfaction, environmental targets, health
4 and safety issues, and individual goals.

5 RUCO believes these criteria provide some benefit to customers.
6 Accordingly, I am recommending a 50/50 sharing of the cost of this portion
7 of the AIP.

8
9 Therefore, I am reinstating 50 percent of this portion of the AIP (\$14,482 X
10 50% = \$7,241).

11
12 Q. Please continue with the clarification and explanation of your surrebuttal
13 adjustment to the Other Reorganization/Downsizing and Non-Incentive
14 Pay expenses.

15 A. RUCO considers the amount of \$42,441 in Other
16 Reorganization/Downsizing and Non-Incentive Pay expenses to be non-
17 recurring and not typical of test-year expenses.

18
19 Therefore, I am removing this amount from the Arizona Corporate
20 allocated management fees.

21 . . .

22 . . .

23 . . .

1 Q. Please summarize RUCO's surrebuttal adjustment to the first element of
2 administrative and general allocated costs - the Arizona Corporate
3 allocated management fees.

4 A. I reinstated half of 70 percent of the AIP, which is the portion that provides
5 shared benefits to both the shareholders and ratepayers.

6

7 As shown on SURR RLM-12, page 1, column (A), line 2 this adjustment
8 increases adjusted test-year expenses by:

9 \$7,241.

10

11 Q. Please discuss the second element of the Company's rebuttal adjustment
12 to the Central Division Corporate district allocated miscellaneous
13 expenses.

14 A. The Company has accepted the majority of RUCO's adjustment, but
15 rejects three items:

- 16 1. Ice for \$1,989;
17 2. Lawn maintenance for \$9,137; and
18 3. Security services for \$1,261.

19

20 These costs are then allocated to PV Water on an 8.12 percent allocation
21 factor.

22 . . .

23 . . .

1 Q. Please explain RUCO's denial of the purchase of ice as an acceptable
2 operating expense to be burdened on the ratepayers.

3 A. As general principle RUCO maintains certain categories of expenses
4 should not be the financial burden of the ratepayers. For example (but not
5 limited to): Liquor, Coffee, Water, Ice, Sodas, Smoothies, Bagels, Donuts,
6 Subs, etc.

7
8 Q. Please explain RUCO's denial of the cost for lawn maintenance as an
9 acceptable operating expense to be burdened on the ratepayers.

10 A. RUCO believes it is disingenuous to the ratepayers to burden them with
11 the cost of the Company's lawn maintenance while recommending a rate
12 design to encourage conservation and penalizes customers who consume
13 water to enhance their own landscaping.

14
15 Q. Please discuss the Company's explanation of the security service costs.

16 A. RUCO accepts the costs of the security service as explained more fully in
17 the Company's rebuttal testimony.

18
19 Q. Please summarize RUCO's surrebuttal adjustment to the second element
20 of administrative and general allocated costs - the Central Division
21 Corporate district allocated miscellaneous expenses.

22 A. I reinstated 8.12 percent of the \$1,261 cost for security services or \$102
23 (\$1,261 X 8.12% = \$102).

1 As shown on SURR RLM-12, page 1, column (A), line 3 this adjustment
2 increases adjusted test-year expenses by:
3 \$102.

4

5 Q. Please discuss the third element of the Company's rebuttal adjustment to
6 the Arizona Corporate allocated miscellaneous expenses.

7 A. The Company has accepted the majority of RUCO's adjustment but
8 rejects eight items:

- 9 1. Human Resources Classified Advertisement for \$5,273;
- 10 2. Indoor Plant Maintenance for \$547;
- 11 3. Security Renovations and Remodeling for \$1,023;
- 12 4. Human Resources Classified Advertisement for \$5,353;
- 13 5. Management Job Search for \$33,660;
- 14 6. NAWC Dues for \$17,895;
- 15 7. Directors' Fees for \$15,687; and
- 16 8. Amortization of Reorganization and Centralization for \$105,120.

17

18 Q. After analyzing the Company's rebuttal testimony, is RUCO revising its
19 adjustments to the Arizona Corporate allocated miscellaneous expenses?

20 A. Yes. RUCO will accept the Company's rebuttal testimony and reinstate
21 items: 1, 4, 5, 6, 7 and 8; but rejects items 2 and 3 as appropriate test-
22 year operating expenses.

23 . . .

24 . . .

25 . . .

1 Q. Please explain your rejection of item 2 – Indoor Plant Maintenance for
2 \$547.

3 A. RUCO disallows indoor plant maintenance as a necessary expense in the
4 provisioning of water service.

5
6 Q. Please explain your rejection of item 3 - Security Renovations and
7 Remodeling for \$1,023.

8 A. RUCO disallows renovations and remodeling as a nonrecurring non-
9 typical historical test-year expense.

10

11 Q. Please summarize RUCO's surrebuttal adjustment to the third element of
12 administrative and general allocated costs - the Arizona Corporate
13 allocated miscellaneous expenses.

14 A. I reinstated 8.12 percent of: the Human Resources Classified
15 Advertisement for \$5,273; Human Resources Classified Advertisement for
16 \$5,353; Management Job Search for \$33,660; NAWC Dues for \$17,895;
17 Directors' Fees for \$15,687; and Amortization of Reorganization and
18 Centralization for \$105,120.

19

20 Thus, this adjustment increases the direct testimony adjustment by
21 \$14,859 [(\$5,273 + \$5,353 + \$33,660 + \$17,895 + \$15,687 + \$105,120 =
22 \$182,988) X 8.12% = \$14,859]

23 . . .

1 As shown on SURR RLM-12, column (A), line 4 this adjustment increases
2 adjusted test-year expenses by:
3 \$14,859.

4

5 Q. Please summarize your total adjustment to the administrative and general
6 allocated costs.

7 A. RUCO made the following increases to the administrative and general
8 allocated costs:

9	1. Arizona Corporate allocated management fees	\$7,241
10	2. Central Division Corporate miscellaneous expenses	\$102
11	3. Arizona Corporate allocated miscellaneous expenses	<u>\$14,859</u>
12	Total	\$22,202

13

14	RUCO's Adjusted Expense	\$640,236
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15	RUCO's Direct Testimony Adjusted Expense	<u>\$618,034</u>
----	--	------------------

16	RUCO's Surrebuttal Adjustment	\$22,202
----	-------------------------------	----------

17

18 As shown on Schedule SURR RLM-3, page 3, column (L), line 22, this
19 adjustment increases adjusted test-year expenses by:

20 \$22,202.

21 . . .

22 . . .

23 . . .

24 . . .

25 . . .

Operating Income Adjustment No. 16 – Income Tax Expense

Q. What adjustments have you made to the test-year Income Tax Expense account?

A. As shown on Schedule SURR RLM-16, I recalculated total test-year income taxes to reflect calculations based on my surrebuttal adjusted test-year revenue and expenses.

As shown on Schedule SURR RLM-3, page 4, column (P), line 35, this adjustment decreases adjusted test-year expenses by:
(\$21,154).

ARSENIC COST RECOVERY MECHANISM

Q. After reviewing the Company's response to the concerns raised in your direct testimony about the prudence of a thorough review of the costs associated with PV Water's arsenic facility, does RUCO feel it is now adequately informed to accept the estimated \$23.2 million as a fair and reasonable cost for the ACRM Step One recovery of the Company's capital investment?

A. No. However, I appreciate PV Water's attempt to reassure RUCO. The Company has performed its due diligence, but since the cost of the Company's arsenic facility is not an issue in the instant case the time is not ripe for a thorough analysis of the estimated cost breakout.

...

1 In response to RUCO's preemptive acknowledgement of concern,
2 Company witness Mr. Gross filed 62 pages of testimony associated with
3 arsenic recovery. This does not indicate in anyway there are irregularities
4 in the project, but it does prove there are complex issues of far more
5 intricacy than can be rationally disposed of during an Opening Meeting in
6 September 2006.

7

8 I am not a professional engineer and therefore will have to rely on Staff
9 Engineering in large part to make a sound judgment on the various
10 technical aspects of these projects that come into question during the
11 ACRM Step One process.

12 Mr. Gross provided Attachment A, depicting a detailed cost breakdown
13 among the three simultaneous projects; at first glance, unfortunately, it
14 seems many joint expenditures are largely committed to the arsenic
15 removal.

16

17 Mr. Gross comments on my concern about the appropriateness of the
18 additional storage capacity costs, which are included as an arsenic
19 recovery expense. He explains there has been a serious shortfall of
20 existing storage since 1997. This response hardly provides justification for
21 the cost of a new 1.5 million gallon storage tank being included in the
22 ACRM Step One filing.

23 . . .

1 Mr. Gross alludes to the fact the project provides no capability for treating
2 water other than the removal of arsenic, since the present supply of well
3 water meets all other quality standards. My interest is knowing what
4 enhancements, if any, would be required to process CAP water.

5
6 Mr. Gross mentioned that Staff engineering visited the arsenic removal
7 site, but no one from RUCO has done so. This is a false and uniformed
8 statement; on October 26, 2005, I had an escorted and informative tour of
9 the arsenic removal project site, the MRTF, the recently installed fire flow
10 infrastructure and a general overview of the PV Water's service territory.
11 It was during this visit that I compiled a list of concerns relevant to RUCO's
12 involvement in PV Water's ACRM Step One filing when and if the
13 Company begins the process by docketing its application.

14
15 Q. Is RUCO aware, and should the Company be cognizant, of Staff's
16 anticipated treatment for its analysis and recommendation of the
17 appropriate level of capital expenditure for the Company's arsenic
18 recovery costs?

19 A. Yes. Commission Staff's anticipated treatment of arsenic cost recovery
20 was thoroughly explained during AZ-AM's previously filed Docket No. W-
21 01303A-05-0280 requesting the implementation of an ACRM for three of
22 its other water Districts.

23 . . .

1 Transcripts of the Hearing for July 26, 2005 on page 81, starting at line 10
2 records the Administrative Law Judge (“ACALJ”) Nodes posing the
3 following question:

4 “It sounds as if what you are saying is Staff is planning on
5 doing some kind of more in-depth analysis at the time the
6 Company would submit its first request for recovery through
7 the ACRM?”

8
9 Staff witness Mr. Chelus responded in the affirmative.

10 Further into his examination ACALJ Nodes, on page 84, starting at line 3,
11 requested clarification in the following question:

12 “So the process, as you see it unfolding, is there will be
13 some continuing ongoing data requests and communications
14 with the Company as to where they are in the process of
15 installing this equipment and then, at the time that the
16 various ACRM step proposals are submitted, Staff will
17 review those and attempt to determine whether those were
18 the least cost methodology available for treating the arsenic,
19 is that right?”

20
21 Staff witness Mr. Chelus responded in the affirmative.

22
23 Still further into his examination ACALJ Nodes, on page 94, starting at line
24 14, requested additional clarification in the following question:

25 “Ms. Brown, I had originally directed this to Mr. Chelus and
26 he kind of deferred the question to you with respect to, I
27 guess, the procedure, process that you anticipate occurring

1 once the Company submits its request for step or ACRM
2 charges. And so let me kind of go through, make sure I
3 understand what, how Staff anticipates this unfolding.

4
5 Once Staff reviews the Company's submittal and
6 RUCO also reviews it and neither RUCO nor Staff have any
7 concerns with it, is it your understanding then that Staff
8 would prepare an order for the Commission's consideration
9 at an Open Meeting?"

10
11 Staff witness Ms. Brown responded in the affirmative.

12
13 ACALJ Nodes continues:

14
15 "But if there was some factual dispute by either Staff or
16 RUCO and it was necessary to conduct a Hearing, then
17 once that Hearing was conducted, the Hearing Division
18 would prepare the order for the Commission's
19 consideration?"

20
21 Staff witness Ms. Brown responded in the affirmative.

22
23 Q. Do you believe the Staff also anticipates that the process of implementing
24 ACRM Step One for PV Water will ultimately entail more review and
25 analysis than a mere Open Meeting?

26 A. Yes. Based on the above Staff testimony I believe the Staff is anticipating
27 a comprehensive process, which is consistent with my direct testimony on
28 this subject.

- 1 Q. Does this conclude your surrebuttal testimony?
- 2 A. Yes, it does.

**SURREBUTTAL
TABLE OF CONTENTS TO RLM SCHEDULES**

SCHEDULE NO.	PAGE NO.	TITLE
SURR RLM-1	1	REVENUE REQUIREMENT
SURR RLM-2	1 & 2	OPERATING INCOME
SURR RLM-3	1 TO 4	SUMMARY OF OPERATING INCOME ADJUSTMENTS
SURREBUTTAL TESTIMONY		EXPLANATION OF OPERATING INCOME ADJUSTMENT NO. 1 - RECLASSIFIED OFFICE LEASE
NO ADJUSTMENT		EXPLANATION OF OPERATING INCOME ADJUSTMENT NO. 2 - NORMALIZED GROUP INSURANCE
NO ADJUSTMENT		EXPLANATION OF OPERATING INCOME ADJUSTMENT NO. 3 - NORMALIZED OPEB EXPENSES
SURREBUTTAL TESTIMONY		EXPLANATION OF OPERATING INCOME ADJUSTMENT NO. 4 - RATE CASE EXPENSE
SURR RLM-6	1	EXPLANATION OF OPERATING INCOME ADJUSTMENT NO. 5 - PENSION EXPENSES
NO ADJUSTMENT		EXPLANATION OF OPERATING INCOME ADJUSTMENT NO. 6 - MATERIALS & SUPPLIES WRITE-OFF
SURR RLM-7	1	EXPLANATION OF OPERATING INCOME ADJUSTMENT NO. 7 - NORMALIZED PAYROLL
NO ADJUSTMENT		EXPLANATION OF OPERATING INCOME ADJUSTMENT NO. 8 - TEST YEAR DEPRECIATION EXPENSE
NO ADJUSTMENT		EXPLANATION OF OPERATING INCOME ADJUSTMENT NO. 9 - PROPERTY TAX COMPUTATION - ADJ. # 1
NO ADJUSTMENT		EXPLANATION OF OPERATING INCOME ADJUSTMENT NO. 10 - PROPERTY TAX COMPUTATION - ADJ. # 2
SURR RLM-11	1	EXPLANATION OF OPERATING INCOME ADJUSTMENT NO. 11 - NORMALIZED PAYROLL TAXES
SURR RLM-12	1	EXPLANATION OF OPERATING INCOME ADJUSTMENT NO. 12 - ADMIN. & GEN. CORPORATE ALLOCATION
NO ADJUSTMENT		EXPLANATION OF OPERATING INCOME ADJUSTMENT NO. 13 - CAPITALIZED O & M EXPENSES
		ADJUSTMENT NO. 14 - LEFT BLANK
		ADJUSTMENT NO. 15 - LEFT BLANK
SURR RLM-13	1	EXPLANATION OF OPERATING INCOME ADJUSTMENT NO. 16 - INCOME TAX EXPENSE

**SURREBUTTAL
REVENUE REQUIREMENT**

LINE NO.	DESCRIPTION	(A) COMPANY AS FILED OCRB/FVRB	(B) COMPANY REBUTTAL OCRB/FVRB	(C) RUCO DIRECT OCRB/FVRB	(D) RUCO SURREB'L OCRB/FVRB
1	Adjusted Rate Base	\$ 11,651,216	\$ 15,166,114	\$ 10,898,953	\$ 10,908,989
2	Adjusted Operating Income (Loss)	\$ 742,769	\$ 864,157	\$ 1,045,440	\$ 1,012,134
3	Current Rate Of Return (Line 2 / Line 1)	6.38%	5.70%	9.6%	9.28%
4	Required Operating Income (Line 5 X Line 1)	\$ 913,455	\$ 1,188,556	\$ 773,826	\$ 774,538
5	Required Rate Of Return	7.84%	7.84%	7.10%	7.10%
6	Operating Income Deficiency (Line 4 - Line 2)	\$ 170,686	\$ 324,399	\$ (271,615)	\$ (237,596)
7	Gross Revenue Conversion Factor (Schedule RLM-1, Page 2)	1.6286	1.6286	1.6286	1.6286
8	Increase In Gross Revenue Requirement (Line 7 X Line 6)	\$ 277,980	\$ 528,328	\$ (442,361)	\$ (386,957)
9	Adjusted Test Year Revenue	\$ 5,070,680	\$ 5,079,195	\$ 5,070,680	\$ 5,070,680
10	Proposed Annual Revenue Requirement (Line 8 + Line 9)	\$ 5,348,660	\$ 5,607,523	\$ 4,628,319	\$ 4,683,723
11	Required Percentage Increase In Revenue (Line 8 / Line 9)	5.48%	10.40%	-8.72%	-7.63%
12	Rate Of Return On Common Equity	12.00%	12.50%	10.00%	10.00%

References:

Column (A): Company Schedule A-1, C-1 And D-1
Column (B): Schedules TJC-3, RLM-1 (Page 2), SURR RLM-2 And WAR-1

**SURREBUTTAL
SUMMARY OF OPERATING INCOME**

LINE NO.	DESCRIPTION	(A) COMPANY TESTIMONY AS FILED	(B) RUCO DIRECT TESTIMONY ADJUSTMENTS	(C) RUCO DIRECT TESTIMONY AS ADJUSTED	(D) RUCO SURR'L TESTIMONY ADJUSTMENTS	(E) RUCO SURR'L TESTIMONY AS ADJUSTED	(F) RUCO PROPOSED CHANGES	(G) RUCO AS RECOMMENDED
OPERATING REVENUES:								
1	Residential	\$ 3,868,204	\$ -	\$ 3,868,204	\$ -	\$ 3,868,204	\$ -	\$ 3,868,204
2	Commercial	928,050	-	928,050	-	928,050	-	928,050
3	Turf	76,712	-	76,712	-	76,712	-	76,712
4	Turf - Country Club	166,994	-	166,994	-	166,994	-	166,994
5	Miscellaneous	925	-	925	-	925	-	925
6	Sales For Resales	13,270	-	13,270	-	13,270	-	13,270
7	Fire Service	4,439	-	4,439	-	4,439	-	4,439
8	Other	12,468	-	12,468	-	12,468	-	12,468
9	Motorola	-	-	-	-	-	-	-
	Unbilled Adjustment							
10	Residential	-	-	-	-	-	-	-
11	Commercial	-	-	-	-	-	-	-
12	Total Water Sales	5,071,062	-	5,071,062	-	5,071,062	(442,361)	4,628,701
13	Difference To G/L	(382)	-	(382)	-	(382)	-	(382)
14	TOTAL OPERATING REV.	<u>\$ 5,070,680</u>	<u>\$ -</u>	<u>\$ 5,070,680</u>	<u>\$ -</u>	<u>\$ 5,070,680</u>	<u>\$ (442,361)</u>	<u>\$ 4,628,319</u>
OPERATING EXPENSES:								
Operations								
15	Source Of Supply	\$ 67,292	\$ (1,847)	\$ 65,445	\$ -	\$ 65,445	\$ -	\$ 65,445
16	Purchased Power	812,312	-	812,312	-	812,312	-	812,312
17	Pumping Expense	4,416	-	4,416	-	4,416	-	4,416
18	Chemicals	16,499	-	16,499	-	16,499	-	16,499
19	Water Treatment	6,914	-	6,914	-	6,914	-	6,914
20	Transmission & Distribution	74,437	(32,389)	42,048	-	42,048	-	42,048
21	Customer Accounting	62,854	-	62,854	-	62,854	-	62,854
22	Administrative & General	1,378,856	(204,438)	1,174,418	46,041	1,220,459	-	1,220,459
23	Operations Labor	403,162	(92,863)	310,299	5,721	316,020	-	316,020
24	Total Operations Exp	<u>\$ 2,826,742</u>	<u>\$ (331,537)</u>	<u>\$ 2,495,205</u>	<u>\$ 51,762</u>	<u>\$ 2,546,967</u>	<u>\$ -</u>	<u>\$ 2,546,967</u>

**SURREBUTTAL
SUMMARY OF OPERATING INCOME - CONT'D**

LINE NO.	DESCRIPTION	(A) COMPANY TESTIMONY AS FILED	(B) RUCO DIRECT TESTIMONY ADJUSTMENTS	(C) RUCO DIRECT TESTIMONY AS ADJUSTED	(D) RUCO SURR'L TESTIMONY ADJUSTMENTS	(E) RUCO SURR'L TESTIMONY AS ADJUSTED	(F) RUCO PROPOSED CHANGES	(G) RUCO AS RECOMMENDED
	Maintenance							
25	Source Of Supply	\$ 14,552	\$ (2,350)	\$ 12,202	\$ -	\$ 12,202	\$ -	\$ 12,202
26	Pumping	16,309	(6,298)	10,011	-	10,011	-	10,011
27	Water Treatment	(1,277)	-	(1,277)	-	(1,277)	-	(1,277)
28	Transmission & Distribution	118,506	(2,090)	116,416	-	116,416	-	116,416
29	Administrative & General	784	-	784	-	784	-	784
30	Maintenance Labor	148,056	(34,101)	113,955	2,101	116,056	-	116,056
31	Total Maintenance Exp	<u>\$ 296,930</u>	<u>\$ (44,839)</u>	<u>\$ 252,091</u>	<u>\$ 2,101</u>	<u>\$ 254,192</u>	<u>\$ -</u>	<u>\$ 254,192</u>
32	DEPR. & AMORT. EXPENSES	<u>\$ 720,578</u>	<u>\$ (72,676)</u>	<u>\$ 647,902</u>	<u>\$ -</u>	<u>\$ 647,902</u>	<u>\$ -</u>	<u>\$ 647,902</u>
	TAXES							
33	Property Taxes	\$ 213,241	\$ (42,907)	\$ 170,334	\$ -	\$ 170,334	\$ -	\$ 170,334
34	Payroll & Miscellaneous	54,716	(17,204)	37,512	598	38,110	-	38,110
35	State & Federal Income	215,705	206,490	422,195	(21,154)	401,041	(149,361)	251,680
36	Total Taxes	<u>\$ 483,662</u>	<u>\$ 146,379</u>	<u>\$ 630,041</u>	<u>\$ (20,556)</u>	<u>\$ 609,485</u>	<u>\$ (149,361)</u>	<u>\$ 460,125</u>
37	TOTAL OPERATING EXP.	<u>\$ 4,327,912</u>	<u>\$ (302,672)</u>	<u>\$ 4,025,240</u>	<u>\$ 33,306</u>	<u>\$ 4,058,546</u>	<u>\$ (149,361)</u>	<u>\$ 3,909,185</u>
38	OPERATING INCOME (LOSS)	<u>\$ 742,768</u>		<u>\$ 1,045,440</u>		<u>\$ 1,012,134</u>		<u>\$ 719,134</u>

References:

Column (A): Company Schedules C-1 And E-6
Column (B): Testimony, RLM And Schedule RLM-3, Pages 1 Thru 4
Column (C): Column (A) + Column (B)
Column (D): Surrebuttal Testimony, RLM And Schedule SURR RLM-3, Pages 1 Thru 4
Column (E): Column (C) + Column (D)

SURREBUTTAL
SUMMARY OF INCREMENTAL OPERATING INCOME ADJUSTMENTS
TEST YEAR AS RUCO FILED AND SURREBUTTAL ADJUSTED

LINE NO.	DESCRIPTION	RUCO DIR'T TESTIMONY AS ADJ'TED	(A) ADJ #1	(B) ADJ #2	(C) ADJ #3	(D) ADJ #4	(E) ADJ #5	(F) ADJ #6	(G) ADJ #7	(H) ADJ #8
OPERATING REVENUES:										
1	Residential	\$ 3,868,204	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
2	Commercial	928,050	-	-	-	-	-	-	-	-
3	Turf	76,712	-	-	-	-	-	-	-	-
4	Turf - Country Club	166,994	-	-	-	-	-	-	-	-
5	Miscellaneous	925	-	-	-	-	-	-	-	-
6	Sales For Resales	13,270	-	-	-	-	-	-	-	-
7	Fire Service	4,439	-	-	-	-	-	-	-	-
8	Other	12,468	-	-	-	-	-	-	-	-
9	Motorola	-	-	-	-	-	-	-	-	-
	Unbilled Adjustment									
10	Residential	-	-	-	-	-	-	-	-	-
11	Commercial	-	-	-	-	-	-	-	-	-
12	Total Water Sales	5,071,062	-	-	-	-	-	-	-	-
13	Difference To G/L	(382)	-	-	-	-	-	-	-	-
14	TOTAL OPERATING REV.	\$ 5,070,680	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
OPERATING EXPENSES:										
	Operations									
15	Source Of Supply	\$ 65,445	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
16	Purchased Power	812,312	-	-	-	-	-	-	-	-
17	Pumping Expense	4,416	-	-	-	-	-	-	-	-
18	Chemicals	16,499	-	-	-	-	-	-	-	-
19	Water Treatment	6,914	-	-	-	-	-	-	-	-
20	Transmission & Distribution	42,048	-	-	-	-	-	-	-	-
21	Customer Accounting	62,854	-	-	-	-	-	-	-	-
22	Administrative & General	1,174,418	13,408	-	-	9,757	674	-	-	-
23	Operations Labor	310,299	-	-	-	-	-	-	5,721	-
24	Total Operations Exp	\$ 2,495,205	\$ 13,408	\$ -	\$ -	\$ 9,757	\$ 674	\$ -	\$ 5,721	\$ -

ADJUSTMENT NO.
1 - Reclassified Office Lease
2 - Normalized Group Insurance
3 - OPEB Expense
4 - Rate Case Expense

REFERENCE
Testimony, RLM
No Surrebuttal Adjustment
No Surrebuttal Adjustment
Testimony, RLM

ADJUSTMENT NO.
5 - Pension Expense
6 - Write-Off Mat. & Supplies
7 - Normalized Labor
8 - Depreciation Expense

REFERENCE
Testimony, RLM And Schedule SURR RLM-6
No Surrebuttal Adjustment
Testimony, RLM And Schedule SURR RLM-7
Testimony, RLM

SURREBUTTAL
SUMMARY OF INCREMENTAL OPERATING INCOME ADJUSTMENTS - CONT'D
TEST YEAR AS RUCO FILED AND SURREBUTTAL ADJUSTED

LINE NO.	DESCRIPTION	RUCO DIR'T TESTIMONY AS ADJ'TED	(A) ADJ #1	(B) ADJ #2	(C) ADJ #3	(D) ADJ #4	(E) ADJ #5	(F) ADJ #6	(G) ADJ #7	(H) ADJ #8
	Maintenance									
25	Source Of Supply	\$ 12,202	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
26	Pumping	10,011	-	-	-	-	-	-	-	-
27	Water Treatment	(1,277)	-	-	-	-	-	-	-	-
28	Transmission & Distribution	116,416	-	-	-	-	-	-	-	-
29	Administrative & General	784	-	-	-	-	-	-	-	-
30	Maintenance Labor	113,955	-	-	-	-	-	-	2,101	-
31	Total Maintenance Exp	<u>\$ 252,091</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 2,101</u>	<u>\$ -</u>
32	DEPR. & AMORT. EXPENSES	<u>\$ 647,902</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
	TAXES									
33	Property Taxes	\$ 170,334	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
34	Payroll & Miscellaneous	37,512	-	-	-	-	-	-	-	-
35	State & Federal Income	422,195	-	-	-	-	-	-	-	-
36	Total Taxes	<u>\$ 630,041</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
37	TOTAL OPERATING EXP.	<u>\$ 4,025,240</u>	<u>\$ 13,408</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 9,757</u>	<u>\$ 674</u>	<u>\$ -</u>	<u>\$ 7,822</u>	<u>\$ -</u>
38	OPERATING INCOME (LOSS)	<u>\$ 1,045,440</u>								

ADJUSTMENT NO.

- 1 - Reclassified Office Lease
- 2 - Normalized Group Insurance
- 3 - OPEB Expense
- 4 - Rate Case Expense
- 5 - Pension Expense
- 6 - Write-Off Mat. & Supplies
- 7 - Normalized Labor
- 8 - Depreciation Expense

REFERENCE

- Testimony, RLM
- No Surrebuttal Adjustment
- No Surrebuttal Adjustment
- Testimony, RLM
- Testimony, RLM And Schedule SURR RLM-6
- No Surrebuttal Adjustment
- Testimony, RLM And Schedule SURR RLM-7
- Testimony, RLM

SURREBUTTAL
SUMMARY OF OPERATING INCOME ADJUSTMENTS - CONT'D
TEST YEAR AS RUCO FILED AND SURREBUTTAL ADJUSTED

LINE NO.	DESCRIPTION	(I) ADJ #9	(J) ADJ #10	(K) ADJ #11	(L) ADJ #12	(M) ADJ #13	(N) ADJ #14	(O) ADJ #15	(P) ADJ #16	(Q) RUCO AS AD'TED
OPERATING REVENUES:										
1	Residential	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 3,868,204
2	Commercial	-	-	-	-	-	-	-	-	928,050
3	Turf	-	-	-	-	-	-	-	-	76,712
4	Turf - Country Club	-	-	-	-	-	-	-	-	166,994
5	Miscellaneous	-	-	-	-	-	-	-	-	925
6	Sales For Resales	-	-	-	-	-	-	-	-	13,270
7	Fire Service	-	-	-	-	-	-	-	-	4,439
8	Other	-	-	-	-	-	-	-	-	12,468
9	Motorola	-	-	-	-	-	-	-	-	-
	Unbilled Adjustment									
10	Residential	-	-	-	-	-	-	-	-	-
11	Commercial	-	-	-	-	-	-	-	-	-
12	Total Water Sales	-	-	-	-	-	-	-	-	5,071,062
13	Difference To G/L	-	-	-	-	-	-	-	-	(382)
14	TOTAL OPERATING REV.	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 5,070,680</u>
OPERATING EXPENSES:										
Operations										
15	Source Of Supply	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 65,445
16	Purchased Power	-	-	-	-	-	-	-	-	812,312
17	Pumping Expense	-	-	-	-	-	-	-	-	4,416
18	Chemicals	-	-	-	-	-	-	-	-	16,499
19	Water Treatment	-	-	-	-	-	-	-	-	6,914
20	Transmission & Distribution	-	-	-	-	-	-	-	-	42,048
21	Customer Accounting	-	-	-	-	-	-	-	-	62,854
22	Administrative & General	-	-	-	22,202	-	-	-	-	1,220,459
23	Operations Labor	-	-	-	-	-	-	-	-	316,020
24	Total Operations Exp	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 22,202</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 2,546,967</u>

ADJUSTMENT NO.
9 - Property Tax - Adjustment No. 1
10 - Property Tax - Adjustment No. 2
11 - Payroll Taxes
12 - Admin. & Gen. Corporate Allocation

REFERENCE
Testimony, RLM
No Adjustment
Testimony, RLM And Schedule SURR RLM-11
Testimony, RLM And Schedule SURR RLM-12

ADJUSTMENT NO.
13 - Capitalization Of Expenses
14 - Left Blank
15 - Left Blank
16 - Income Tax

REFERENCE
No Surrebuttal Adjustment
Testimony, RLM And Schedule SURR RLM-13

SURREBUTTAL
SUMMARY OF OPERATING INCOME ADJUSTMENTS - CONT'D
TEST YEAR AS RUCO FILED AND SURREBUTTAL ADJUSTED

LINE NO.	DESCRIPTION	(I) ADJ #9	(J) ADJ #10	(K) ADJ #11	(L) ADJ #12	(M) ADJ #13	(N) ADJ #14	(O) ADJ #15	(P) ADJ #16	(Q) RUCO AS AD'TED
	Maintenance									
25	Source Of Supply	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 12,202
26	Pumping	-	-	-	-	-	-	-	-	10,011
27	Water Treatment	-	-	-	-	-	-	-	-	(1,277)
28	Transmission & Distribution	-	-	-	-	-	-	-	-	116,416
29	Administrative & General	-	-	-	-	-	-	-	-	784
30	Maintenance Labor	-	-	-	-	-	-	-	-	116,056
31	Total Maintenance Exp	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 254,192</u>
32	DEPR. & AMORT. EXPENSES	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 647,902</u>
	TAXES									
33	Property Taxes	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 170,334
34	Payroll & Miscellaneous	-	-	598	-	-	-	-	-	38,110
35	State & Federal Income	-	-	-	-	-	-	-	(21,154)	401,041
36	Total Taxes	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 598</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (21,154)</u>	<u>\$ 609,485</u>
37	TOTAL OPERATING EXP.	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 598</u>	<u>\$ 22,202</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (21,154)</u>	<u>\$ 4,058,546</u>
38	OPERATING INCOME (LOSS)									<u>\$ 1,012,134</u>

ADJUSTMENT NO.

- 9 - Property Tax - Adjustment No. 1
- 10 - Property Tax - Adjustment No. 2
- 11 - Payroll Taxes
- 12 - Admin. & Gen. Corporate Allocation
- 13 - Capitalization Of Expenses
- 14 - Left Blank
- 15 - Left Blank
- 16 - Income Tax

REFERENCE

- Testimony, RLM
- No Adjustment
- Testimony, RLM And Schedule SURR RLM-11
- Testimony, RLM And Schedule SURR RLM-12
- No Surrebuttal Adjustment

Testimony, RLM And Schedule SURR RLM-13

**SURREBUTTAL
EXPLANATION OF OPERATING INCOME ADJUSTMENT NO. 5
PENSION EXPENSE**

LINE NO.	DESCRIPTION	REFERENCE	(A)
1	Projected AZ-AM 2005 Pension Funding Expense	Company Workpapers	\$ 296,624
2	Active Pension Participants	Company Response To RUCO Data Request 5.05	136
3	Projected AZ-AM 2005 Pension Funding Expense Per Participan	Line 1 / Line 2	<u>\$ 2,181</u>
4	Direct Full-Time Equivalent Employees Working At Paradise Valley	RUCO Direct Testimony	11.16
5	Additional Full-Time Equivalent Employees Working At Paradise Valley	RUCO Surrebuttal Adjustment (SEE NOTE A)	0.32
6	Surrebuttal Full-Time Equivalent Employees Working At Paradise Valle	Line 4 + Line 5	<u>11.48</u>
7	Projected Paradise Valley 2005 Pension Funding Expens	Line 3 X Line 6	<u>\$ 25,038</u>
	Less		
	Capitalized Portion		
8	Normalized Capital Labor	Direct Testimony RLM-7, Page 1, Line 2	\$ (45,377)
9	Normalized Total Labor	Direct Testimony RLM-7, Page 1, Line 3	<u>\$432,077</u>
10	Percentage Capital Labor Is Of Total Labor	Line 6 / Line 7	-10.50%
11	Capitalized Labor	Line 7 X Capital Labor Of 10.70%	(2,630)
12	RUCO Adjustment	Line 7 + Line 11	\$ 22,409
13	RUCO Direct Adjustment	Direct Testimony Schedule RLM-6, Page 1, Line 10	21,735
14	RUCO Surrebuttal Adj'm't (See SURR RLM-3, Page 1, Column (E), Line 2)	Line 12 - Line 13	<u>\$ 674</u>

NOTE A

15	RUCO Additional Test-Year Labor Hours	Surrebuttal Testimony Adjustment No. 7	665.5
16	RUCO Additional Portion of "Full Time Equivalent Employees	Line 15 / 2080 Reg. Full Time Annual Hours	<u>0.32</u>

SURREBUTTAL
EXPLANATION OF OPERATING INCOME ADJUSTMENT NO. 7
NORMALIZATION OF LABOR - PROJECTED HOURS AND WAGES

LINE NO.	DESCRIPTION	REFERENCE	(A) RUCO AS ADJ'TED
1	Total Payroll - Regular & Overtime (Excluding MRTF) - As Adjusted By RUCO	WP SURR RLM-7, Pg 3, C (E), L 49	\$ 477,454
2	Normalized Total Capitalized Wages - As Calculated By Company	2004 G/L Actuals Plus 3.5% Increase	(45,377)
3	Total Normalized Payroll Expense (Excluding MRTF)	Line 1 + Line 2	<u>\$ 432,077</u>
	Allocation Of Normalized Payroll Expense - As Calculated By Company		
4	Operations Labor @ 73.14%	3 Year Average	\$ 316,021
5	Maintenance Labor @ 26.86%	3 Year Average	116,056
6	Total Normalized Payroll Expense (Excluding MRTF) - As Adjusted By RUCO	Line 4 + Line 5	<u>\$ 432,077</u>
	Normalized Payroll Expense (Excluding MRTF) As Filed By Company		
7	Operations Labor	Company Workpapers	\$ 403,163
8	Maintenance Labor	Company Workpapers	148,056
9	Total Normalized Payroll Expense (Excluding MRTF) As Filed By Company	Line 7 + Line 8	<u>\$ 551,219</u>
	Payroll Adjustments		
10	RUCO Adjustment To Operations Labor	Line 4	\$ 316,021
11	RUCO Direct Adjustment To Operations Labor	Direct Testimony Schedule RLM-7	\$ 310,300
12	RUCO Surrebuttal Adj'm't To Oper's Labor (See SURR RLM-3, Pg 1, C (G), L 23)	Line 10 - Line 11	<u>\$ 5,721</u>
13	RUCO Adjustment To Maintenance Labor	Line 5	\$ 116,056
14	RUCO Direct Adjustment To Maintenance Labor	Direct Testimony Schedule RLM-7	113,955
15	RUCO Surrebuttal Adj'm't To Maint. Labor (See SURR RLM-3, Pg 2, C (G), L 30)	Line 13 - Line 14	<u>\$ 2,101</u>
16	Total RUCO Surrebuttal Adjustment	Line 12 + Line 15	<u><u>\$ 7,822</u></u>

SURREBUTTAL
EXPLANATION OF OPERATING INCOME ADJUSTMENT NO. 11
NORMALIZATION OF PAYROLL TAXES

LINE NO.	DESCRIPTION	REFERENCE	(A)
1	RUCO Adjusted Payroll Expense	SURR RLM-3, C (Q), (Pg 3, L 23) + (Pg 4, L 30)	\$ 432,076
2	RUCO Adjusted Normalized FICA-1 @ 6.20% (Max. \$90,000)	Line 1 X 6.20%	\$ 26,789
3	RUCO Adjusted Normalized FICA-2 @ 1.45%	Line 1 X 1.45%	6,265
4	RUCO Adjusted Normalized FUTA @ 0.80%	NOTE A	1,746
5	RUCO Adjusted Normalized SUTA @ 1.45%	NOTE B	3,165
6	Total	Sum Of Lines 2, 3, 4 & 5	\$ 37,965
7	RUCO Adjustment	Line 6	\$ 37,965
8	RUCO Direct Adjustment	Direct Testimony Schedule RLM-11	37,367
9	RUCO Surrebuttal Adjustment (See SURR RLM-3, Pg 4, Col. (K), Line 34)	Line 7 - Line 8	<u>\$ 598</u>

NOTE A

Calculation Of RUCO Adjusted Normalized FUTA @ 0.80%

9	RUCO Adjusted No. Of Paradise Valley Employees Earning Over \$7,000	WP RLM-4, Pg 5, Col. (E) @ 31	
10	RUCO Adjusted Normalized FUTA @ 0.80%	31 X \$7,000 X 0.80%	\$ 1,736
11	RUCO Adjusted Total Annual Wages For Employees Earning Under \$7,000	WP RLM-4, Pg 5, Col. (E) @ \$1,276	
12	RUCO Adjusted Normalized FUTA @ 0.80%	\$1,276 X 0.80%	10
13	Total RUCO Adjusted Normalized FUTA @ 0.80%	Line 10 + Line 12	<u>\$ 1,746</u>

NOTE B

Calculation Of RUCO Adjusted Normalized SUTA @ 1.45%

14	RUCO Adjusted No. Of Paradise Valley Employees Earning Over \$7,000	WP RLM-4, Pg 5, Col. (E) @ 31	
15	RUCO Adjusted Normalized SUTA @ 1.45%	31 X \$7,000 X 1.45%	\$ 3,147
16	RUCO Adjusted Total Annual Wages For Employees Earning Under \$7,000	WP RLM-4, Pg 5, Col. (E) @ \$1,276	
17	RUCO Adjusted Normalized SUTA @ 1.45%	\$1,276 X 4.45%	19
18	Total RUCO Adjusted Normalized SUTA @ 1.45%	Line 15 + Line 17	<u>\$ 3,165</u>

SURREBUTTAL
EXPLANATION OF OPERATING INCOME ADJUSTMENT NO. 12
RUCO ADJUSTMENT TO ALLOCATED ADMINISTRATION AND GENERAL EXPENSES

LINE NO.	DESCRIPTION	REFERENCE	(A) AMOUNT
1	RUCO Direct Management Fees & Misc. Corp. Office Allocated Expenses	Direct Testimony Schedule RLM-12	\$ 618,034
2	RUCO Adjustment To Management Fees Allocated Expenses	Surrebuttal Testimony	\$ (55,237)
3	RUCO Direct Adjustment To Management Fees Allocated Expenses	Direct Testimony	(62,478)
4	RUCO Surrebuttal Adjustment To Management Fees Allocated Expenses	Line 2 -Line 3	<u>\$ 7,241</u>
5	RUCO Adjustment To Miscellaneous Central Division Allocated Expenses	SURR RLM-12, Pg 2, Col. (E), L 43	\$ (1,102)
6	RUCO Direct Adjustment To Misc. Central Division Allocated Expenses	Direct Testimony Schedule RLM-12	(1,204)
7	RUCO Surrebuttal Adjustment To Misc. Central Division Allocated Exp.	Line 5 - Line 6	<u>\$ 102</u>
8	RUCO Adjustment To Miscellaneous Corporate Allocated Expenses	SURR RLM-12, Pg 4, Col. (E), L 61	\$ (3,374)
9	RUCO Direct Adjustment To Misc. Corporate Allocated Expenses	Direct Testimony Schedule RLM-12	(18,233)
10	RUCO Surrebuttal Adjustment To Misc. Corporate Allocated Expense	Line 8 - Line 9	<u>\$ 14,859</u>
11	RUCO Adjusted Administration And General Allocated Expenses	Sum Of Lines 4, 7,& 10	<u>\$ 22,202</u>
12	RUCO Adjustment	Line 11 + Line 1	\$ 640,236
13	RUCO Direct Adjustment	Direct Testimony Schedule RLM-12	618,034
14	RUCO Surrebuttal Adjustment (See SURR RLM-3, Pg 3, Col. (L), L 22)	Line 12 - Line 13	<u>\$ 22,202</u>

SURREBUTTAL
EXPLANATION OF OPERATING INCOME ADJUSTMENT NO. 16
INCOME TAX EXPENSE

(A)

LINE NO.	DESCRIPTION	REFERENCE	AMOUNT
FEDERAL INCOME TAXES:			
1	Operating Income Before Taxes	RLM-2, Col. (C), L38 + L35	\$ 1,413,175
	LESS:		
2	Arizona State Tax	Line 11	(72,397)
3	Interest Expense	Note (A) Line 19	(374,178)
4	Federal Taxable Income	Line 1 + Line 2 + Line 3	\$ 966,600
5	Federal Tax Rate	RLM-1, Page 2, Col.(A), L 9	34.00%
6	Federal Income Tax Expense	Line 4 X line 5	<u>\$ 328,644</u>
STATE INCOME TAXES:			
7	Operating Income Before Taxes	Line 1	\$ 1,413,175
	LESS:		
8	Interest Expense	Note (A) Line 19	(374,178)
9	State Taxable Income	Line 7 + Line 8	\$ 1,038,997
10	State Tax Rate	Tax Rate	6.97%
11	State Income Tax Expense	Line 9 X Line 10	<u>\$ 72,397</u>
TOTAL INCOME TAX EXPENSE:			
12	Federal Income Tax Expense	Line 6	\$ 328,644
13	State Income Tax Expense	Line 11	72,397
14	Total Income Tax Expense Per RUCO	Line 12 + Line 13	<u>\$ 401,041</u>
15	Total Income Tax Expense Per Company (Per Company Sch. C-1)		215,705
16	RUCO Adjustment (See RLM-3, Page 4, Column (P), Line 35)	Line 14 - Line 15	<u>\$ 185,336</u>
17	RUCO Adjustment	Line 16	\$ 185,336
18	RUCO Direct Adjustment	Direct Testimony Schedule RLM-13	206,490
19	RUCO Surrebuttal Adj'm't (See SURR RLM-3, Pg 4, C (I), L 33)	Line 17 - Line 18	<u>\$ (21,154)</u>
NOTE (A):			
	Interest Synchronization:		
17	Adjusted Rate Base	RLM-1, Page 1, Col. (F), L1	\$ 10,908,989
18	Weighted Cost Of Debt	WAR-1, Col. (F), L1 + L2	3.43%
19	Interest Expense	Line 17 X Line 18	<u>\$ 374,178</u>